COMMONWEALTH OF VIRGINIA

STATE CORPORATION COMMISSION

AT RICHMOND, November 30, 2000

APPLICATION OF

VIRGINIA NATURAL GAS, INC.,

AND

AGL ENERGY SERVICES, INC.

Case No. PUA000085

For approval of an Energy Services Agreement
under Chapter 4 of Title 56 of the Code of Virginia

ORDER GRANTING APPROVAL

On October 16, 2000, Virginia Natural Gas, Inc. ("VNG"), and AGL Energy Services, Inc. ("AGLES"), (collectively, the "Applicants") filed an application under the Public Utilities Affiliates Law requesting approval of an energy services agreement pursuant to which AGLES will provide centralized natural gas procurement and asset management services to VNG.

On May 8, 2000, AGL Resources Inc. ("AGLR") and Consolidated Natural Gas Company ("CNG") entered into a Stock Purchase Agreement pursuant to which AGLR agreed to acquire all of the stock of Virginia Natural Gas, Inc. ("VNG"). The Commission approved the transaction by Order dated July 28, 2000, in Case No. PUA000054. The Federal Trade Commission approved the transaction on September 27, 2000, and the Securities and Exchange Commission (the "SEC") approved the transaction on October 5, 2000. The transaction closed on October 6, 2000. In connection with the transaction, AGLR became a registered holding company. AGLR subsequently established AGL Services Company and by Order dated

September 25, 2000, in Case No. PUA000060, the Commission approved an application for the provision of services by AGL Services Company for VNG.

As indicated in the application, in addition to the centralized services to be provided for VNG by AGL Services Company, VNG needs the services of an entity experienced in managing a comprehensive portfolio of gas supply, transmission, and storage assets in a complex and dynamic marketplace. VNG must have access to dependable, reliable, and affordable sources of natural gas commodity and capacity to discharge its obligations as a utility. AGLES was formed for the purpose of offering centralized gas purchasing and non-distribution asset management services to AGLR's operating subsidiaries. Currently, AGLES provides gas purchasing and asset management services for both Atlanta Gas Light Company and Chattanooga Gas Company.

In the current application, VNG and AGLES specifically request approval of a Gas Supply Asset Assignment and Agency Agreement ("the Agreement"). Pursuant to the Agreement, VNG will have the option of obtaining needed natural gas procurement and asset management services from unaffiliated suppliers or procuring such services from AGLES under the Agreement. VNG will make these choices based on the relative value and cost of the services. The Agreement is meant to supplement the AGLES Services Agreement approved by the Commission in Case No. PUA000060, which was modeled generally on the Dominion Services Agreement, approved in Case No. PUA990068.

In accordance with the Agreement, gas costs for the natural gas procurement services provided by the AGLES will be based on current industry standards. Specifically, VNG's gas costs will be calculated by using (a) monthly indices for baseload and storage injection requirements; (b) daily indices for swing requirements; and (c) unit costs that would be incurred if the firm transportation and storage were used to meet firm requirements.

Pursuant to the Agreement, VNG proposes to allow AGLES to manage its non-distribution assets. VNG represents that AGLES is an asset manager that is well positioned to maximize the value of such assets. An essential task of AGLES as the primary asset manager will be to find, create, and take advantage of physical and financial market opportunities by managing the VNG assets in combination with other assets to meet the requirements of VNG's customers and other markets more efficiently. VNG represents that this task will be achieved in a manner that is fully consistent with VNG's overriding objective of providing reliable service at reasonable prices. Under the Agreement, AGLES will share that value with VNG's customers pursuant to a mechanism that is tied directly to recognized industry benchmarks. VNG proposes that these prudent costs serve as the benchmark for its revenue sharing proposal under which the additional value to be shared would be the difference between the total value actually achieved in a year and the benchmark cost of gas.

VNG represents that the proposed Agreement is in the public interest. VNG states that, by obtaining centralized natural gas procurement and asset management services from a consolidated and centralized source that can achieve economies of scale and other business efficiencies by, among other things, eliminating duplicative personnel and facilities, the price to end-use customers of VNG's delivered natural gas can be minimized. The provision of services by AGLES will also enable VNG and its end-use customers to realize the benefits of innovative natural gas procurement and asset management strategies that might not otherwise have been available to VNG on a stand-alone basis. VNG represents that all of these efficiencies will provide benefits to its customers. Also, basing the gas costs on nationally recognized standards and approving the asset management arrangement could produce significant savings for end-use customers in Virginia. VNG states that, in any event, approval of the proposed Agreement would result in gas costs for its customers being as low or lower than they otherwise would be.

The compensation and expense reimbursement to AGLES provided for in the Agreement for asset management services is based on a share of the value, if any, created from the management of the assets, net of fees and costs to third-parties, if any.

VNG represents that the Agreement will not expose it to more business risk. VNG will be receiving services it must have on an efficient, cost-effective basis from AGLES and may modify selections on 90 days' notice. The risks that gas supply can not be obtained at the prices established in the gas supply agreement or costs incurred pursuant to the asset management agreement will exceed the value created will be borne by AGLES, not VNG.

VNG states that it believes that, if properly managed, the market value of the transportation, storage, and supply assets that VNG now uses to ensure reliable service to its firm customers may be greater than the value that is currently being realized. VNG believes that allowing AGLES to manage them can best enhance the market value of these assets. AGLES will be able to manage these assets in conjunction with other assets to maximize the value of the entire asset portfolio.

Under the proposed Agreement, the proposed sharing arrangement will allocate the first $1,000,000 annually of value directly to VNG with any additional value being shared on a 65%-AGLES, 35%-VNG basis. The revenues that are realized from capacity release and from the sharing mechanism will flow back to VNG customers as credits through the PGA.

The proposed $1,000,000 sharing threshold (or guarantee as the Applicants stated) reflects VNG's capacity release related revenues for a recent twelve month period. This revenue level reflects a significant decline from capacity release revenue generated over the 18 months prior to VNG being sold to Atlanta Gas Light Company. Capacity release revenue for the third quarter of each year from 1996 thorough 1998 averaged approximately $800,000. Capacity release revenue was approximately $500,000 for the third quarter of 1999 and continued to fall to approximately $100,000 by the second quarter of 2000.

Based on the historical levels of revenue realized from capacity release, there is concern that the floor as proposed is too low and that the proposed sharing mechanism may not reflect a level of capacity release revenue comparable to what VNG's customers would be credited had VNG continued to manage its gas supply assets. In other words, the sharing mechanism could possibly allow AGLES to share value that it did not create. Since VNG's firm customers bear the full cost of the capacity assets that create the capacity release revenues, the full amount of direct capacity release revenue should be flowed back to VNG's firm customers. There is also concern that gas supply reliability could potentially be degraded if capacity releases are made on a non-recallable basis.

The Applicants and Staff discussed these issues and agreed to a number of revisions that would resolve these concerns. These revisions require changes to Articles 1, 3.1, and 3.2 of the proposed affiliate agreement. The Applicants also provided additional information regarding the terms for released capacity.

The first revision will modify the definition of value as contained in Article 1 of the Affiliates' Agreement. The revised definition of Value will be as follows:

> "Value" means, for each Contract Year, the sum of the net revenues created through AGLES' management of the Supply Assets (inclusive of VNG's payments for citygate deliveries of Gas purchased by AGLES as agent for VNG under Section 2.2(b) less the actual costs of such citygate deliveries), plus the transportation credits received by VNG from its upstream transporters as a result of VNG's releases of capacity to parties other than AGLES, and minus any amounts due the Non-Affiliated Asset Manager. "Value" may be expressed mathematically as follows:

V=(A+B)-C
Where
"V" is the Value for the Contract Year,

"A" is an amount equal to the transportation credits, if any generated during the Contract Year as a result of capacity releases by VNG of capacity under contract to VNG that has not been assigned to AGLES ("VNG Capacity Release Credits"),

"B" is equal to the sum of the net revenues created through AGLES' management of the Supply Assets (inclusive of VNG's payments for citygate deliveries of Gas purchased by AGLES as agent for VNG under Section 2.2(b) less the actual costs of such citygate deliveries), and

"C" is equal to the amount, if any, due the Non-Affiliated Asset Manager for the Contract Year.

Additional revisions would modify paragraphs (a) and (b) of Article 3.1 to read as follows:

(a) One hundred percent (100%) of the greater of (i) the first one million dollars ($1,000,000) or (ii) VNG Capacity Release Credits shall be allocated to VNG's firm customers.

(b) Any Value in excess of the greater of (i) one million dollars ($1,000,000) or (ii) VNG Capacity Release Credits shall be allocated thirty-five percent (35%) to VNG's firm customers and sixty-five percent (65%) to AGLES until AGLES receives a cumulative amount of one million dollars ($1,000,000), and then such Value shall be allocated fifty percent (50%) to VNG's firm customers and fifty percent (50%) to AGLES.

There is also concern that the proposed Agreement could potentially alter the timing of direct capacity release revenues being flowed back to retail customers since the original Agreement will credit VNG annually. Direct capacity release revenues are currently credited quarterly. Consequently, an additional provision will preserve the current schedule for crediting direct capacity release revenues to firm customers. This new provision will be included as Article 3.2. Acceptance of this provision will necessitate renumbering the originally proposed Article 3.2 to 3.3. The revised Article 3.2 will read as follows:

> 3.2 The Calculation of Value pursuant to the formula set forth in the Article I definition of Value is an annual determination of the total Value generated over a Contract Year. During a Contract Year, VNG shall allocate VNG Capacity Release Credits received by VNG in accordance with the Section 3.1 allocation methodology. The year-end allocation of Value under Section 3.1 shall take account of the allocation of VNG Capacity Release Credits during the course of the Contract Year.

This revenue sharing generated from AGLES's use of VNG's assets preserves the return to VNG's firm customers of all revenues generated from capacity release. It also provides AGLES with an incentive to make use of VNG's assets in a manner that will generate opportunity (off-system) gas sales and preserve a portion of those opportunity sales for VNG's firm customers. The reliability of VNG's gas service to its retail customers will not be impaired by this Agreement as all of the current safeguards relating to capacity release/recapture remain in place, assuring that those assets are available to meet VNG's firm customer load.

As mentioned previously, the Agreement calls for the gas cost for services provided by AGLES to be billed to VNG using monthly indices for base load and storage injection gas, and daily indices for swing gas requirements. In order to accomplish this, the Agreement provides for dividing VNG's gas service into four Tiers. Tier I or base load gas is priced at an amount per MMBtu equal to the weighted average of the first-of-the-month indices published in *Inside FERC* using the quantities of firm transportation service ("FT") entitlements under storage-related FT contracts. Tier II or swing gas is priced at an amount per MMBtu equal to the weighted average of the daily indices published in *Gas Daily* for the day. Tier III utilizes storage to meet load and is priced at an amount per MMBtu equal to the weighted average storage withdrawal and fuel costs, including transportation costs, that would have occurred under VNG's gas storage contracts. Tier IV or peaking gas will be provided by propane vaporization service. VNG will retain control and proprietary use of its propane production facilities. Therefore, there will be no charge from AGLES to VNG for peaking use of propane. The use of indices for pricing commodity supplies to VNG should not negatively impact VNG's retail rates since such purchases have historically been priced at the indices plus a premium.

The Applicants agreed to provide the Staff with documentation and information and with quarterly PGA filings that will allow the Staff to monitor the operation of the gas supply agreement. This information will include:

a) System commodity cost and allocation to VNG,
b) Index rates used,
c) Off-system sales revenue,
d) Direct capacity revenue,
e) Indirect Capacity revenue,
f) VNG capacity cost for the period,
g) Calculation of off-system margins, and
h) Calculation of VNG commodity margins.

THE COMMISSION, upon consideration of the application and representations of the Applicants and having been advised by its Staff, is of the opinion and finds that the above-described Agreement, as modified, will provide for an equitable sharing of the risks and potential benefits associated with AGLES' management of VNG's gas supply assets. The Agreement will also preserve the reliability of VNG's gas supplies and provide needed services that will allow VNG to avoid the incurrence of additional costs associated with procuring and managing gas supplies. We find that the Agreement as modified above would be in the public interest and should be approved. Accordingly,

IT IS ORDERED THAT:

1) Pursuant to § 56-77 of the Code of Virginia, VNG and AGLES are hereby granted approval of the Gas Supply Asset Assignment and Agency Agreement under the terms and conditions and for the purposes as described herein, subject to the above-referenced modifications.

2) Should there be any changes in the terms and conditions of the Agreement from those contained herein, Commission approval shall be required for such changes.

3) The approval granted herein shall not preclude the Commission from exercising the provisions of §§ 56-78 and 56-80 of the Code of Virginia hereafter.

4) The approval granted herein shall have no ratemaking implications.

5) The Applicants shall submit the following information quarterly to both the Division of Public Utility Accounting and the Division of Energy Regulation: (1) detail of system commodity cost and allocation to VNG, (2) index rates used and supporting documentation, (3) off-system sales revenue and supporting detail, (4) direct capacity revenue and supporting detail, (5) indirect capacity revenue and supporting detail, (5) VNG capacity cost for the period and supporting detail, (6) calculation of off-system margin and supporting detail, (7) calculation of VNG commodity margin and supporting detail, and (8) any other information that the Staff deems necessary.

6) The Commission reserves the authority to examine the books and records of any affiliate in connection with the approval granted herein whether or not the Commission regulates such affiliate.

7) Within thirty (30) days of the date of this order, the Applicants shall submit a revised executed copy of the Agreement to both the Commission's Division of Public Utility Accounting and Division of Energy Regulation incorporating the modifications to the Agreement as described herein.

8) The Staff is directed to monitor the arrangement approved herein to ensure that it continues to be in the public interest.

9) VNG shall include the Agreement in its Annual Report of Affiliate Transactions submitted to the Director of Public Utility Accounting of the Commission.

10) There appearing nothing further to be done in this matter, it hereby is dismissed.